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February 8, 2010

Chairman Ben Bernake  
Gov. Elizabeth A. Duke  
Director Sandy Braunstein  
Board of Governors of the Federal Reserve System  
Division of Consumer and Community Affairs  
20<sup>th</sup> Street and Constitution Avenue  
Washington, DC 2051

Re: Docket No. R1366, Proposed Amendments to Regulation Z / TILA

Dear Mr. Bernake; Gov. Duke; Dir. Braunstein; and Board Members;

I am writing to you in response to R-1336; Proposed Amendments to Reg. Z for Closed-end Mortgages. After learning of a letter that was sent to you by 17 U.S. Senators; I felt it was critically important for me to respond. I am very concerned about the negative impact that these amendments will have on consumers and the mortgage industry. I am equally concerned about the comments made in the Senators' letter.

First, allow me to provide some background. I own a small mortgage brokerage in New Jersey and have worked in the industry for 12 years. Before starting my business I was an executive with a large national lender. I have worked in all aspects of the loan origination and underwriting process. I have developed and managed large departments, created underwriting manuals and implemented lending protocols. I have dealt with clients, originators, underwriters, attorneys, investors, secondary markets, ever-changing regulation and the regulators themselves. I am a seasoned professional in the industry and I hope that you consider my comments and concerns with the same regard.

R-1336 will, without a doubt, prevent my small business from continuing to operate. I urge The Board to read my letter in its entirety. I am trying to save my business, protect consumers, and help thousands of other mortgage professionals. In addition to this letter I have submitted comments through The Board's website. I have also sent copies of this letter to members of The House Financial Services Committee, the Senate Banking Committee, and my local representatives.

On September 2, 2009; The Board proposed new rules and amendments to Regulation Z of the Truth in Lending Act. A major component of those amendments was the elimination of yield spread premiums (YSP). The Board went further by proposing a ban on all loan originator compensation that was tied to interest rates or loan terms. Most of my concerns are surrounding that portion of R-1366. I agree with the other proposed changes of R-1366 including the addition of more simplified disclosures.

I have written this letter after reviewing all of The Board's reports, memorandums, and consumer testing results on loan originator compensation. I hope to demonstrate that these amendments will: 1. fail to create their intended result, 2. create un-due burdens on consumers, 3. increase the cost of obtaining credit, 4. raise unemployment, 5. have a devastating impact on small business, 6. weaken the already fragile real estate market, and 7. ultimately make it more difficult for consumers to access credit. **Contrary to The Board's statements; I feel that the negative consequences of R-1366 will far outweigh the assumed and unproven benefits to consumers.**

### **Reason for Amendments / The Real Cause of the Problem**

The motivation behind R-1366 is easy to see. There are countless homeowners that were harmed by unscrupulous loan advisors who were only interested in their own gains. Many have been forced from their homes because they were unaware or simply misled about their loan transactions. Because of this; I wholeheartedly agree with The Board that sweeping reforms must be made.

However, I disagree with The Board's ideas for remedying the situation. I think The Board is wrong to believe that yield spread premiums are to blame. These issues were not caused by the rates consumers were charged, or by the manner in which lenders share revenues with brokers. Instead, the real problems were largely a result of the "exotic" or non-traditional mortgage loans which readily available in the market. Consumers were uneducated about these programs.

Everyone is aware of these types of loans; negative amortization loans or Pay Option loans; adjustable rate mortgages; Interest Only loans; prepayment penalty loans, and stated income loans amongst others. These loans all carried negative consequences to the consumers and all had a major role in the subsequent housing collapse gripping our nation.

Consumers were simply unaware of the risks that these loans carried. Some were led to believe that the risks were minimal when, in fact, they were substantial. Thousands were "steered" into these products which often appeared to be a better alternative to traditional financing. I will argue to The Board that the root problem here is "steering", not compensation or YSP.

Worse yet, many borrowers were never told that their payments and loan balances would rise. They assumed their payments would stay the same forever. Homeowners were unfamiliar with how these loans worked. Many of these loans were so complex that industry professionals themselves could not fully understand them. Some of the brightest minds in the nation did not immediately recognize the risks. For example; even a few of our largest banking institutions gambled with these alternative mortgage products and lost.

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Compounding the issue was the fact that these “exotic” loan programs paid higher commissions to the originators who produced them. Lenders and investors would pay significantly more for these loans.<sup>1</sup> The overall consensus was that these loans would be more profitable for investors. Therefore, regardless of the negative consequences investors ultimately wanted higher returns and paid loan originators more for getting the loans.

As a result many loan originators, often inexperienced and untrained, jumped on the bandwagon and kept feeding the investor appetite. Thousands of homeowners were ill-advised into these loan programs and were later left with unaffordable mortgage payments. Again, I agree with The Board that things must change to ensure this never happens again.

However, The Board is not proposing anything that would protect consumers from making these misinformed decisions in the future. These loans depleted entire pension plans, toppled Wall Street, left people homeless, and eroded billions in property values. Clearly these “exotic” mortgages wrecked havoc but The Board isn’t proposing anyway to prevent in the future. The Board isn’t even considering any regulations which require consumers to be educated on the mortgages they are choosing. The Board has admitted through its own reports that many borrowers don’t understand the complexities of mortgage lending

Instead The Board is focused on eliminating loan originator compensation without having any proof that it will be an improvement. Although the answer is really rather simple, The Board is choosing to enact rules that will actually do more damage than good. The side effects of R-1366 would be detrimental to consumers. Nothing is being solved by eliminating loan originator compensation. Actually, The Board is creating new problems and changing the industry. This at a time when the real estate market and mortgage lending is at its most fragile state? I will prove this to The Board and propose alternatives that address, and effectively solve the true issue.

**Conclusion: The real problem lies in complex exotic loan terms which borrowers could not understand. Borrowers were placed into loans that didn’t suit their needs or lifestyle. The problem isn’t originator compensation, it is consumer education.**

### **The Truth About Yield Spread Premiums**

After reading The Board’s materials and the letter written by those 17 Senators; it’s clear that there are many misconceptions about yield spread premiums. All of the reports published by The Board accuse brokers of providing interest rates that are higher than what consumers would have otherwise qualified for. The Board seems to believe that brokers charge higher rates than what lenders would be willing to accept. The Board describes yield spread premium as: *“the dollar value difference between the lowest rate that a lender would have accepted on a particular transaction and the interest rate that the loan originator actually obtained for the lender”*. That statement and The Board’s view are incorrect. There is a misunderstanding of the wholesale lending channel and the function of brokers.

The Board must understand how Wholesale Lenders determine the “buy” rate or “par” rate. The “par” rate is the lowest interest a lender would be willing to charge based on the expenses they incur in order to make the loan. The wholesale lender only takes into account their underwriting and subsequent secondary packaging expenses when determining the “par” rate. Of course, the risk exposure for the lender is also encompassed in the “par” rate.

However, the “par” rate does not account for expenses associated with originating the loan. Also, “par” does not account for the loan processing expenses or marketing expense used to obtain clients. Lastly, “par” rate does not account for compensation to staff and sales people who originate loans and work with clients. All of these are essential in the mortgage industry.

This is why The Board’s definition of YSP is so incredulous. The lowest rate that wholesale lenders are willing to charge for a loan does not include any of the expenses I just mention because the lenders don’t incur those expenses. This is why wholesale lenders allow us to package loans at higher rates so that we can cover those expenses.

Another point to consider is that both lenders and brokers must account for fallout expenses. A large percentage of loan applications never materialize. This is due to a variety of reasons. Maybe the borrower didn’t qualify, or the property value is insufficient, or rates simply not compelling enough. Fallout is unavoidable.

Yet every application has a cost, regardless of fruition. Fallout and the expense it creates is simply part of doing business. The Board must understand that this is another expense that lenders and brokers have. All of these costs must be factored into the “retail” rate that brokers offer to their clients.

There’s more. Not every loan requires the same amount of time, effort, or talent to complete. Depending on characteristics of the loan, the property, and the borrower could cause a particular loan to take substantially more time and effort to consummate. For example; cooperative property mortgages are more complex than standard loans. Borrowers with past bankruptcies or foreclosures require more processing time and labor. Loans with multiple borrowers might require more consultations, phone calls, and general time. The list goes on but ultimately both the broker and lender have significantly higher expenses when completing those transactions.

It is because of these dynamics that yield spread premiums must exist. The fundamental business understanding between broker and wholesale lender is that ***both parties must bear the costs of producing loans and both parties must receive a portion of the revenues generated by the loans.*** This is why wholesale lenders allow us to determine how much revenue a loan must generate in order to be profitable.

Sadly, The Board has narrow mindedlly labeled yield spread premiums as simply compensation. The Senators’ letter calls them “unethical kickbacks”, which is completely ridiculous. Brokers incur costs on every loan they originate and process. Essentially, yield spread premiums are the most fair business relationship for wholesale lenders and brokers. It allows them to share expenses and portions of the revenues on every loan transaction.

I say “portions” because not all revenue is paid to the broker. Make no mistake about it, wholesale lenders profit from yield spread premiums. A broker might receive 2% in YSP for a loan that is 0.5% above “par” rate. However, that 0.5% increase is actually going to generate substantially more revenue for the wholesale lender than what is paid to the broker. The wholesale lender is only paying 2% in yield spread premium because the end investor is paying more for loans at that certain rate. Lenders don’t want brokers to only deliver “par” rate loans. They need the higher rate loans and they count on that profit. This is why banning the payment of yield spread premiums won’t lower consumer rates. Lenders will still charge the higher rate; they just won’t be sharing some of the revenues with the broker.

Therefore, when The Board states that brokers deliver higher rates than what lenders would be willing to accept it is an insulting misconception. Wholesale lenders would not be willing to offer “par” rates to consumers if they had to market, originate and process the loans themselves. They simply would not be profitable at “par” rates and would have to charge the same “retail” rates that brokers offer.

The lenders that do all functions of originating and funding loans also offer “retail” rates. There are many lenders that are involved in both retail and wholesale. If you were to compare the “par” rates they publish to their “retail” rates, there would be a significant difference. They are two completely separate things, totally incomparable. Ultimately, brokers deliver “retail” rates to consumers just like retail banks.

Yield spread premiums also provide flexibility and competition between loan originators. Brokers will often provide rates lower than large retail lenders. The reason is that we can better control our costs. Brokers don’t have to generate as much revenue per transaction in order to be profitable. This allows us to beat the competition by running our businesses effectively. This type of competition is what drives our economy. It’s that simple, that’s business, that’s capitalism.

**Conclusion: Wholesale rates don’t include the expense of loan origination. Yield spread premiums are not simply “broker compensation”. Brokers and lenders share in the costs of producing loans and in the revenues generated by the loans. Not all revenues from yield spread premiums are paid to brokers; lenders depend on higher rates for added profit. Retail rates are different from wholesale rates. Brokers compete with lenders and competition is good for consumers.**

### **How Banks Will Pay: Consumer’s Costs Will Rise**

The Board is only entertaining two options for loan originator compensation. These two choices pertain to employees of mortgage lenders and mortgage brokers. The first option states that loan originators compensation cannot be related to the loan terms in any way. Terms are defined as; loan amount, rate, penalties, etc. The second option would allow for loan originators to be compensated based on the loan amount or volume. This could be as a percentage of volume or a flat fee based on volume. The Board further proposes that no matter which option is chosen, loan originators are only allowed to receive compensation from either lender or borrower, but not from both. This means that if the loan originator earns anything from the lender, they cannot charge the borrower for their services as well. All of this will increase consumer costs.

The first option would definitely create a shortage of loan originators in the industry. Banks and lenders would be forced to pay a flat amount on every transaction regardless of loan size, credit quality, risk, etc. It is impossible to determine what the appropriate flat amount of compensation should be. Loan originator compensation would be reduced across the board. This is because lenders will have to choose a flat payment that is sensible, safe, and profitable regardless of the loan size or characteristics. The only safe choice would be lower compensation on all loans.

The next problem is that lenders have a different profit margin based on loan size, credit quality, loan to value percentage, etc. Investors pay more or less depending on those characteristics. A \$350,000 loan at 5.00% is worth more than a \$125,000 loan at 6.00%. When you factor in credit scores, loan to value percentages, and other factors; the differences are staggering. This is the basics of the secondary mortgage market. The Board should be very familiar since you have been purchasing mortgage backed securities for over a year.

So option 1 creates a very unfair environment. We'll use The Board's example of \$3,000 in compensation per loan. This means that all brokers receive \$3,000 on all loans. If a broker receives a \$3,000 commission for a \$100,000 loan, it would be a very high commission for a small loan. The commission paid could equate to more than half of the first year interest payments. When you consider the expenses associated with boarding a loan and servicing a loan; \$3,000 would be a lot to pay in commission. On the other hand a \$3,000 commission would be a fair amount for a \$200,000 loan.

In this scenario the only solution would be for the lender to charge consumer higher rates and more fees on smaller loans. The lender could also choose to not offer smaller loan amounts. This would clearly increase consumer costs. This would be more prevalent for borrowers with lower qualifications since they normally can only afford smaller homes. This would be a negative impact for those borrowers who can least afford it.

The other solution would be to lower compensation. Maybe something like \$1,500 per \$100,000 would be fair. However, the lender would be forced to pay all originators \$1,500 per transaction regardless of loan size or characteristics. But a \$1,500 commission would be very little for a \$650,000 loan. If you consider how much profit a lender would make by selling a \$650,000 loan to their investor, then paying a \$1,500 commission is extremely unfair.

Here's something else to consider; some loans require a significant amount of work to come to fruition. I can name numerous examples of loans that required several months of work before we could close. It is part of the business sometimes. You have to be willing to work with clients and wait until credit scores increase, or savings go up, or something is corrected. We wouldn't do all of the work needed if we were only making \$1,500 on those transactions. It just doesn't make sense to spend 90 days working on one transaction for \$1,500.

So what happens to those borrowers? Do they simply become ignored because loan originators feel it's not worth dealing with them? Obviously loan originators would gravitate towards simpler, easier transactions. If they are only making \$1,500 per loan then loan originator must close more loans in less time to make a living. Complicated transactions would be discarded. The time needed would not be worth the compensation on those loans. There wouldn't be many loan originators working on them as it would be self defeating to do so. Again, borrowers who can least afford to go without assistance would be left out of the equation.

The Board is also proposing to limit who can pay the loan originator. Loan originator can either charge the borrower for their services or receive the compensation from the lender, but not from both. Under those circumstances, if a loan originator felt that a transaction would be difficult then they will opt to charge the borrower more in fees instead of receiving a small commission from the lender. Again, what happens to borrowers that cannot pay the additional fees? Maybe they don't have the money to add to their down payments. Or maybe there isn't enough equity in the home to pay the fees. What happens to those borrowers? The negative possibilities here are endless.

Again I ask! The Board, what becomes of these borrowers? Should they be ignored? Before these proposals, a borrower could choose to pay for some of the loan originators compensation up front and to finance some of it through the interest rate. This allowed them to pay it over time. Under R-1366 this option would go away for consumers. It is senseless and doesn't help the consumer.

**Conclusion: Forcing banks or lenders to compensate loan originators in a flat commission structure is unfair. It will also cause an increase in costs for borrowers with less than perfect credit and with lower loan amounts. This point also defeats The Board's claim that the positive impact of these proposals would outweigh the negative ones, the opposite is demonstrated here.**

### **Making the Problem of Steering WORSE**

The Board's other compensation option would allow loan originators to be compensated based on the loan size or volume. While this would avoid the problems of a flat commission for every loan; it would create new problems. Option 2 still creates a situation where consumer costs are increased and the problem of steering is worsened. As The Board knows, steering is the issue of loan originators advising borrowers to take loans that are not in their best interest so the loan originator can generate more compensation. I have stated from the beginning of this letter that the true problem is steering, not yield spread premiums.

Lenders will have to compensate loan originators the same way that most insurance companies do with their agents. Loan originators would basically get a "quote" for the loan on behalf of the borrower. Based on the characteristics of the loan; lenders would set the rate and terms. That rate would not be flexible, similar to an insurance policy.

Lenders would then have a couple of choices for compensating loan originators. 1. Lenders would provide an amount of compensation along with the loan quote. An example would be a lender paying \$4,800 for a \$250,000 loan with a 650 fico score and a 10% down payment. 2. Lenders could compensate originators by a set percentage amount. For example; a lender could pay 2% of every loan to the originator. A \$250,000 loan with a 650 fico score and a 10% down payment would then earn \$5,000 in commission.

No matter what the loan originator would not control the rate or terms of the loan. The lender would dictate that without flexibility. Again, very similar to insurance quotes. But there are major problems with these methods that The Board has not considered.

The main problem would be that loan originators would simply direct borrowers to the lenders who are paying the most. Let's say that one lender was willing to pay a broker 2.5% on every loan while another lender was only paying 2% on every loan. Obviously the loan originator is going to bring their borrowers to the lender paying 2.5%

The issue is that lenders who pay more commission will need to charge higher rates or less than favorable terms. So even though loans from the lender paying 2% are better for the consumer; loan originators will persuade borrowers into loans from the lender paying 2.5%. History has already shown us that this is exactly what will happen.

Consider the negative amortization loans that took over the market a few years ago. The lenders making those loans were paying higher commissions to loan originators. So what happened? A large number of loan originators started advising borrowers to take negative amortization loans.

The same principle applies to loan officers that are employed by lenders. Loan officers will want to work with the lender paying the most. The lender paying the most will definitely offer higher rates to consumers. So what's the end result? More steering for compensation and nothing is solved.

**Conclusion: Steering is at the root of our problems. The Board's limit on who can pay the originators will worsen the problem. Since originators can only get paid from the lender or the borrower, but not both, it will increase consumer costs. First because loan originators will charge higher fees to make up for the loss of yield spread premiums. Secondly, loan originators will steer clients into loans from lenders that offer more compensation. Lenders offering more compensation will likely have higher rates and less favorable terms. All of this makes our issues worse, not better.**

### **Underwriting Difficulties: Fewer Will Qualify**

The most significant consequence of eliminating yield spread premiums will be that fewer borrowers would qualify for loans. As it is today, very few American's can qualify for home loans. A lack of investors in the secondary mortgage market has left Americans with very limited mortgage options. This dilemma has occurred absent of any added regulation.

As a matter of fact, if it wasn't for The Federal Reserve's mortgage bonds purchasing program; the entire market might have collapsed. Very few investors are interested in mortgage backed securities. Those that are still investing in mortgages are only purchasing loans that are issued to the most qualified borrowers. This is leaving a large part of our population out of the mortgage and homeownership arena. I will even venture to say that, oddly enough, the same politicians who are now criticizing the mortgage industry for being too loose will eventually start criticizing the industry for being too strict.

Eliminating yield spread premiums would only make it more difficult for consumers to qualify. You see, yield spread premiums actually increases flexibility for consumers. Flexibility is extremely necessary in mortgage lending. No two borrowers are exactly alike. Every scenario is a little bit different and that requires some flexibility in order to qualify borrowers.

Under R-1366, loan originators are not be able to change the rate quoted from the lender. Ironically, neither can the lender. So the rate quoted cannot change. This creates a problem with debt to income calculations.



Debt to income calculation is the most important underwriting component. It is what all of our issues have stemmed from; the borrower's ability or inability to repay. Debt to income calculation looks at whether a borrower's income is sufficient to carry a new home loan and all other debts. It is the crux of lending. You can't expect to receive monthly payments from a borrower if their income isn't enough to cover their bills.

Underwriters use a simple formula to decide if a borrower's debt to income calculation is acceptable. For the most part it's a percentage equation, usually no more than 50%. This means that for both FHA loans and Fannie Mae or Freddie Mac loans, the borrower's total monthly payments cannot exceed 50% of their income.

Now let's consider how this will work if loan originators are not allowed to change interest rates. Loan originators will have to shop different lenders for rate quotes. Lenders will only quote three basic interest rates. The first rate would be a higher rate and it would provide for loan originator compensation. The next rate would be a "par" rate which wouldn't provide for loan originator compensation. The final rate, the lowest, but requires a buy-down or discount points paid to the lender.

There will be thousands of borrowers who do not qualify due payments on loans with the higher rates. Additionally, many of these borrowers wouldn't be able to pay the loan originator compensation in order to obtain the lower rate. Clearly if the borrower cannot afford to pay the originator's compensation then they wouldn't be able to pay discount points for an even lower rate.

This scenario is disastrous. It would require loan originators to work for no compensation or the borrower goes without a loan. I can guarantee that if loan originators are unable to earn income from a transaction; they will not pursue those borrowers. This is by far the worst of all the consequences. I can assure The Board that by eliminating yield spread premiums; fewer borrowers will qualify.

Currently this problem does not exist. Today borrower's have the flexibility to choose how originators receive compensation. First, the borrowers can choose to have all of our compensation incorporated into the interest rate, which they pay over time. Next, borrowers can choose to pay for our compensation through the closing costs of the loan. This could be paid from the loan itself (refinance), or from the borrower's own proceeds (purchase). More commonly the choice for borrowers is to split our compensation between the rate and closing costs.

Let's use a frequent example: FHA has a minimum down payment requirement of 3.5% for borrowers purchasing a home. A large number of the borrowers that utilize FHA programs only have a 3.5% down payment. Naturally, borrowers that only have a 3.5% down payment earn a lower income. This is why they don't have more than 3.5% for a down payment. This is why FHA was initially created; to help those borrowers attain homeownership.

In many FHA loans we are running up against a debt to income calculation problem. If a borrower chooses to pay our compensation through a higher interest rate, then the payment might be too high for their debt to income to be acceptable. Usually we are close, but the higher rate and payment takes us over the threshold. We are usually over by a percent or two, which can be frustrating. Again, this is because they have lower income levels.

Conversely, the borrower may not have enough money saved up to pay our compensation in addition to the other closings costs. Normally they just have the required 3.5% down payment and nothing more. So adding two or three thousand in costs would be impossible for them to cover.

However, in today's environment we have a solution. Borrowers can choose to split our compensation. We can offer the borrower a lower rate which would enable their debt to income to be acceptable. This lower rate doesn't generate as much compensation for the originator, but it does reduce the borrowers payments. Since a portion of our compensation is covered by this new rate, then the borrower doesn't have to pay as much up front.

In cases where a borrower is still unable to pay any of our compensation along with their down payments, then many originators just choose to accept the reduced compensation covered by the lower rate. It may not be what the originator hoped to earn, but it's better than not generating any revenue at all. Now we have a situation where the home buyer is able to qualify and the loan originator is able to earn some income. I call that a happy medium.

R-1366 would eliminate this opportunity. It's important to note that this isn't a far fetched unlikely scenario either. It is happening everyday on thousands of transactions. But under R-1366 what becomes of these borrowers? Should they be precluded from the dream of homeownership? Is that really what The Board wants to achieve?

If The Board enacts R-1366 the flexibility in mortgage lending would be gone. There would no longer be a way to reach middle ground. Borrowers must either qualify with higher rates that include our compensation or they must have the funds or equity to pay our compensation. There wouldn't be another option.

I hope The Board sees that this isn't sensible. R-1366 would create a situation where the borrowers that need the most help are unable to get it. The borrowers that need the most flexibility won't get any at all. R-1366 would stifle our housing rebound, reduce homeownership, and plunge us deeper into an already grueling recession.

**Conclusion: Eliminating yield spread premiums would reduce flexibility in mortgage lending. Further limiting loan originator compensation to only come from one source, either the borrower or the lender, will make inflexibility a larger problem. The way the system works today, affords opportunity for many would-be homeowners. By reducing flexibility The Board would reduce the number of American's that can qualify for loans.**

### **Competition Sets Price – Consumers Do Shop for Rates**

The Board issued reports and test results suggesting that many consumers only apply with one or two mortgage providers. The Board states that consumers often come to work with their broker or lender because they've worked with them in the past or were referred to them. Some consumer testing also suggested that consumers rarely apply with different mortgage providers. This report suggested that about half of the test participants inquired about a mortgage loan with more than one provider.

The Board uses this as their basis for eliminating yield spread premiums and limiting originator compensation. The Board professes that consumers cannot effectively protect themselves because they are not likely to apply, shop, and negotiate with several mortgage providers.

I disagree with The Board's assumptions in this case. The Board and the consumer testing procedures were not objective. First, the testing procedures began with a pre-assumed notion that consumers need to apply with several mortgage providers to assure the best possible loan terms. What The Board fails to consider is the fact that consumers may indeed be comparing loans terms, just not the way The Board assumes is adequate.

The Board has to understand that consumers don't need to physically apply with multiple mortgage providers in order to determine if they have a competitive offer. There is no need. Consumers are bombarded with mortgage rate information on a daily basis. Consumers get marketing emails with low rate offers constantly. They receive news updates discussing "weekly average rates". Their internet homepage likely has mortgage information blasting at them. Consumers also see rate offers in local newspapers, television, radio, and in the mail. They will often speak with co-workers, family, friends, and other advisors about available rates. They are absolutely aware of what's competitive in the market or not. So they don't need to actually apply with other mortgage providers.

Shockingly this fact is discussed in the ICF testing reports commissioned by The Board. ICF actually discussed that many consumers do shop around for mortgage offers. They just did so before completing an application. ICF demonstrated how consumers did a lot of research with friends and family or on-line before applying for a loan. How can The Board decide that consumer's need protection when your own test reports demonstrate that consumers do shop?

To think that consumers aren't savvy and informed about mortgage rates is naïve. Consumers will compare a mortgage offers with friends and with multi-media information received everyday. If a consumer feels that their offer is not competitive with current advertisements; then they will explore other mortgage providers. However, if the consumer is satisfied and feels their offer is in-line, then they have no reason to shop amongst mortgage providers.

The notion that consumers are simply accepting of any offer is ridiculous. There is entirely too much easily accessible mortgage information to consumers. Mortgage providers are very aware of this and must prepare their initial offers to be competitive. Otherwise, the consumer may reject the offer and simply find another provider.

This is a very effective way for consumers to negotiate rates and ensure favorable terms. I know from personal experience, I deal with it all the time. As a mortgage broker my offer is constantly being compared to the newest low rate advertisement in newspapers or on-line. Borrowers are constantly using this type of “window rate shopping” to compare my offer with what is readily available. “Window rate shopping” is a safe, quick, and an easy way for consumers to evaluate their offer.

Some consumers do “window rate shopping” to a fault. They believe that they qualify for the lowest advertised rate regardless of their situation. At times consumers may not understand the details that determine the rate. They believe that if a 4.5% is being advertised, they should be able to obtain 4.5% regardless of credit worthiness. Consumers don’t always understand that loan to value percentages, loan amounts, and income has a lot to do with their rate. Many won’t stop shopping until they obtain those advertised rate and, consequently, many pass up on good opportunities.

There are several other reasons why consumers may be reluctant to shop between mortgage providers. Consumers understand mortgage providers can’t accurately prepare a good faith estimate without taking a complete application. Consumers are very hesitant to do this. First, because there is a fear amongst consumers that **running their credit too many times will negatively impact their fico scores**. Secondly, consumers are very afraid of identity theft.

Even the Federal Trade Commission advises consumers to protect their social security numbers. **The FTC suggests that consumers should never provide their social security numbers or dates of birth via the telephone, mail, or internet.** The Board can visit the following website to learn more: <http://www.ftc.gov/bcp/edu/pubs/consumer/idtheft/idth01.shtm>.

This can be confusing for consumers. On one side The Federal Reserve is advising them to shop around for their mortgage. While on the other hand The Federal Trade Commission is advising them not to provide the sensitive information necessary to complete an application.

I argue that consumers are indeed comparing mortgage offers all of the time. They compare the mortgage information they receive from the news and the internet with any rate offer that is presented to them. This is a sign of our times. The accessibility and speed of information has actually made the mortgage industry more competitive, not less. Just because consumers are not submitting full applications to several different mortgage providers doesn’t mean they aren’t shopping around. This is easily evidenced by how mortgage applications spike whenever there is news that mortgage rates came down. Consumers are absolutely paying attention.

Of course, none of this is considered or discussed in any of The Board’s findings or reports. The Board hasn’t evaluated how this impacts the mortgage industry and the way consumers make decisions. I think The Board must take this into account. You can’t say that consumers need protection without analyzing their habits first.

Another shocking fact is that some of the ICF testing that The Board commissioned for actually discussed that many consumers did shop around for mortgage offers. Like I explained; they just did so before completing an application. How can The Board decide that consumer’s need protection because they cannot understand Yield Spread Premiums and do not shop around enough. However, those portions of the IC Macro TILA report demonstrate that consumers do a lot of research online or through friends and family BEFORE applying. Still, The Board has failed to consider this in its evaluations. Why?

**Conclusion: Consumers do shop around; they just don't submit full loan applications. There is plenty of information available to help consumers decipher if their offer is competitive. The Board hasn't factored the abundance of mortgage information into their assumptions. Consumers are taught that they should be reluctant to provide sensitive information, so they likely "window rate shop". The Board's belief that consumers are naïve or need extraordinary protection is unfounded and antiquated.**

### **Bank Rates vs. Broker Rates & How Consumers View YSP**

Further evidence that there is strong competition in the mortgage market is the fact that loans originated by brokers have similar rates to loans originated by retail mortgage lenders. Regardless of Yield Spread Premiums, rates between brokers and direct lenders are relatively the same. This is yet again another topic that The Board does not discuss in your literature.

This further proves the misconceptions about yield spread premiums. Brokers do not charge higher rates than retail banks. In essence, borrowers are facing a similar interest rate regardless of whether they work with a direct lender or a broker. The reason, as I explained before, is that "retail" rates must generate sufficient revenue to cover all expenses associated with originating and funding of loans.

Currently, there are several direct lenders and banks that do not compensate their originators based on the rate of the loan. Lenders like; Wells Fargo, Bank of America, and Chase pay their originators based on volume not rate. Yet still mortgage rates amongst brokers and those direct lenders are comparable. Why is that?

Allow me to provide an example. Recently my company closed a loan for a borrower at a rate of 5.125% with no points. The client had originally applied with Chase where and was quoted 5.375% for the same loan. We were able to beat the rate offered by Chase, a direct lender. Subsequently, we earned 2.375% in yield spread premium for that transaction. Chase was the wholesale lender that funded the loan for us.

My example leads me to ask The Board; what is wrong with us earning a yield spread premiums when our rates are the same rate lower rate than direct lenders? What is the point? What is the advantage to the borrower?

Let's look at what happened when The Board thought that consumers needed to be aware of yield spread premiums paid to brokers. The Board commissioned ICF Macro to conduct some testing on the effectiveness of a mortgage broker yield spread premium disclosure. The Board hoped to introduce this required disclosure thinking that it would benefit consumers in some way.

Ironically, The ICF Macro reports demonstrated that consumers who were asked to sign a broker yield spread premium disclosure were often confused. The report stated that no matter how many times the disclosure was modified to be clearer, consumers would erroneously believe that working with a broker was more expensive than working with a direct lender. More interesting is the fact that ICF and The Board did recognize that working with a broker is not more expensive than working with a direct lender. Since the disclosure made consumers feel this way, The Board opted to abandon the mortgage broker yield spread premium disclosure. The Board announced that the disclosure did not accomplish the intended result of showing consumers the yield spread premiums earned by brokers.

Here's my question: Why did The Board feel that consumers must be aware of yield spread premiums if The Board itself recognizes that working with a broker is not more expensive than working with a direct lender?

This begs more questions: Why exactly does The Board feel that consumers need to be protected from yield spread premiums? What will eliminating YSP ultimately do for consumers? The Board has not identified what the benefit of eliminating yield spread premiums will be to consumers.

Let's consider that several lenders are currently not compensating originators based on rates, yet still their rates are comparable, if not higher, than broker rates. I think it can be determined that eliminating yield spread premiums won't produce a tangible benefit to consumers. Instead, doing so will only lessen competition and destroy small broker businesses across the country. Just because borrowers will have to go to direct lenders doesn't mean that rates will suddenly go down and consumers won't suddenly receive better terms.

Surprisingly, The Board's literature doesn't mention comparing rates between brokers and lenders. I'm not sure why there has not been any comparison studies done, but there certainly should be. Doesn't it make sense to determine if there is a problem with yield spread premiums? Are there any proven negative consequence because brokers earn yield spread premiums? Shouldn't we study institutions that currently do not compensate originators based on loan terms? What would we find if we compared their rates to broker rates?

**Conclusion: Both brokers and lenders ultimately charge consumers comparable "retail" interest rates. Currently there are lenders that do not compensate originators based on rate. However, they don't offer lower rates than brokers. There should be more testing done to determine if eliminating yield spread premiums will provide a benefit to consumers.**

### **Flawed Consumer Testing: Failure to be Objective**

The Board places a lot of emphasis on the Consumer Testing Reports prepared by ICF. They are your basis for eliminating yield spread premiums. But after reading through these reports I have some serious concerns with the objectivity, and value the reports provide. The Board should re-evaluate the information provided on these reports and request additional testing.

One report, which The Board placed much emphasis on, is the ICF Macro Report for Mortgage Broker Disclosures. In this report; the type of consumer testing and the number of consumers tested was simply inadequate. There were only thirty five (35) participants interviewed. Of those thirty five participants ONLY nine (9) were confirmed to have actually used a broker to obtain their mortgage. The rest of the participants were unsure if they used a broker or a lender. How can The Board choose to eliminate yield spread premiums based on nine (9) confirmed broker clients?

Another issue is that ICF was compiling data for two very different reports using the same participants at the same time. ICF Macro only used a total of 135 interviewees during their rounds of testing. During each round; ICF was polling for the Mortgage Broker Disclosure report as well as The TILA Disclosure report. The Mortgage Broker Disclosure testing was conducted as just a side portion to the TILA disclosure report.

How can The Board make decisions with this sort of information? Eliminating yield spread premiums is a drastic change to the industry. I think that more than thirty five (35) borrowers should be interviewed. This is especially true when you consider that these 35 borrowers were already being polled about other mortgage disclosure examples.

I believe it would be prudent to interview more than thirty five (35) participants. More importantly the interviewees should only focus on the topic of broker compensation. A change of this magnitude should warrant a separate isolated report dealing solely with mortgage brokers and clients. Participants should not be asked about other disclosures and complicated documents. There should certainly be more than nine (9) confirmed broker clients as well.

The Board isn't utilizing the reports objectively either. The Board seems to only take the parts of the report which support the elimination of yield spread premiums. The Board is not using the report to make a decision. Instead, The Board is using segments of the report to support a previous, pre-determined decision that yield spread premium should be banned.

For example, the Mortgage Broker Disclosure testing assumes that yield spread premiums to brokers must be disclosed. Yet prior to the testing there was no evidence to suggest that yields spread premiums were something consumers are concerned about. I believe that if The Board did ask, they would find that consumers don't put much weight on yield spread premiums. Instead consumers worry about the rate, costs, term length, and payments of their loan. This is truly what concerns consumers.

I do know that The Board received complaints for Consumer Advocacy Groups regarding yield spread premiums. The Board mentions that during its 2007 HOEPA Hearing it received several comments about the "fairness and transparency of yield spread premiums". However, this isn't sufficient reason for The Board to eliminate yield spread premiums. Consumer groups are not lenders or brokers. Many of these groups could actually be confused or misinformed about the yield spread premiums. Naturally whenever a consumer group is unsure about something they deem that it should be eliminated.

The Board has the responsibility of determining if yield spread premiums are indeed unfair or deceptive. This is The Board's mandate from Congress. The Board can't just assume that yield spread premiums are detrimental to consumers based on concerns from consumer groups. Likewise, The Board should not succumb to pressure from consumer groups or politicians. The Board must be the educated body of authority on these issues as it is clear that yield spread premiums don't cost consumers more.

After reviewing all of the reports it is obvious that The Board should commission for more testing before banning of yield spread premiums. The Board should first determine if yield spread premiums are in fact deceptive or unfair or if consumers are concerned about it. The Board should also test a larger number of confirmed broker clients.

**Conclusion: Consumer testing was done with a small number of interviewees. There has not been sufficient testing done to justify a ban on yield spread premiums. Some consumer testing results contradicts The Board. The Board must conduct more objective testing before implementing such a drastic change.**

### **More Industry Input Needed**

There are other substantial factors missing from The Board's testing reports. I was unable to find any testing or polling conducted with brokers or wholesale lenders. It seems The Board did not conduct any sort of industry polling before suggesting these changes. Why is that? I believe that a significant amount of industry testing and input is required before making this decision. The Board should inquire with wholesale lenders and brokers about the importance of yield spread premiums and how it impacts their business.

The Board should also examine large national lenders that are currently not compensating originators based on rates. There should be a study done to determine whether or not this change in compensation benefits the consumer. What was the outcome of changing this type of compensation? Did rates suddenly drop amongst those lenders? What, if anything, improved?

Lastly, The Board should look at average interest rates between retail lenders and mortgage brokers. This will help determine if brokers are indeed charging higher rates than what consumers would have otherwise qualified for. There is no mention in any of The Board's reports which suggests this type of research was done. I think it is very important. Perhaps The Board has not conducted this type of testing because it fears the results may contradict R-1366.

**Conclusion: The Board should initiate more industry input and testing. There is nothing proving that eliminating yield spread premiums would improve consumer costs or interest rates. There should be definitive proof as to The Board's claim that brokers charge higher rates than what consumers would qualify for.**

### **Allow Upcoming Changes to Take Affect**

The Board should realize that there are several changes affecting the mortgage industry right now. The Board should allow these changes to take place before making a decision on yield spread premiums. It is possible that these new rules, regulations, and education requirements could make the ban on yield spread premiums unnecessary.



For example; Congress recently passed the SAFE Act which requires brokers and originators to complete several hours of course work, pass an exam, and meet continuing education requirements. This will have a huge impact on the industry and we conduct ourselves. We are very excited about it. So why not allow the SAFE act to take affect before making these additional changes?

Also, HUD has introduced a new Good Faith Estimate which provides consumers with a form to compare mortgage offers. As a matter of fact the new GFE actually instructs consumers to shop around. This new Good Faith Estimate is radically different and shows yield spread premiums as an upfront cost to consumers. This instantly places yield spread premiums into the forefront of all conversations between brokers and clients. Why not allows this new Good Faith Estimate to make an impact before eliminating yield spread premiums?

Additionally, we have the recent implementation of The Home Valuation Code of Conduct (HVCC) which prevents originators from having any influence over appraised values. HVCC has eliminated to conflict of interest between loan originators and appraisers. FHA has also implemented a similar version to their appraisal process. All of this will have positive influences over the industry.

These changes and new regulations are just now starting to hit the industry. I think it would be prudent for The Board to explore how the industry will change as a result. It's important to consider what reforms will already take place before enacting such damaging regulation as R-1366.

**Conclusion: There are new regulations that will have a positive impact on the industry and protect consumers. The Board should allow these changes to take affect before imposing such a harsh and potentially negative regulation on the industry. Over-regulation has proven to be damaging to most industries.**

### **Yield Spread Premiums Are NOT Unfair or Deceptive**

The Board has a congressional mandate to stop abusive lending and unfair or deceptive practices in the mortgage industry. The Board has stated that it believes yield spread premiums should be categorized as an unfair and deceptive mortgage business practices. The Board adds many consumers view the role of their broker to be a trusted advisor. Consumers feel that brokers are supposed to search for the best possible loan terms. For some reason The Board feels that this assumption is reason enough to label yield spread premiums as unfair and deceptive. I believe it is a bit of a stretch to consider yield spread premiums unfair and deceptive. Especially when you consider the fact that yield spread premiums as now disclosed to borrowers up-front.

Unfair and deceptive practices are things that clearly mislead consumers into believing they are receiving a particular type of transaction when, in fact, they are receiving a completely different type of transaction. An example of this would be a consumer who is told they will receive a fixed rate when, in reality, they are entering into an adjustable rate. Another example is deceptive advertising in order to lure unsuspecting consumers. Yield spread premiums are nothing like that. They are a business arrangement between a broker and lender, and they are a way for borrowers to finance their broker's compensation.

I know the concept of yield spread premiums is complicated and difficult for an average person to understand. However, just because it's complicated doesn't make YSP an unfair or deceptive practice. Again, yield spread premiums are the only way that wholesale lenders and mortgage brokers can share in the costs and revenues of their loans. It would actually be unfair to ban YSP.

Let me pose some questions to The Board. Is a broker being untruthful or deceptive when they present a mortgage offer as the best possible terms they can obtain? How can The Board make that assumption? What if the broker has accounted for their expenses on originating that loan? What if the broker has calculated how much revenue must be generated in order to be profitable on that loan? What if the rate offer generates the appropriate amount of revenue needed? Is the broker still being deceptive because they could, theoretically, give the consumer the "par" rate? Since when has making a profit been labeled as an unfair and deceptive business practice?

Here's an example: Let's say a consumer has decided to shop for a loan with me and Bank of America. Bank of America is offering a rate of 5.50% while I'm offering 5.25%. Both loans are identical in costs. In a capitalistic economy I should win that consumer's business, because I was more competitive. However, The Board is stating that I am being unfair and deceptive because I was able to earn yield spread premiums on that transaction. Is Bank of America being unfair and deceptive in this example? If I deliver a rate that is lower than my competition; then what is unfair or deceptive about earning a yield spread premium in conjunction?

The Board's stance is that I am indeed being unfair or deceptive in that scenario. The Board implies that if the wholesale lender has a "par" rate of 5.00%; then I am deceptive for not offering that rate to the consumer. But "par" rates don't include any compensation to the originator. So The Board is basically saying that earning compensation is unfair and deceptive. Well is Bank of America being deceptive since they could, theoretically, offer a lower rate and just be less profitable? This idea that yield spread premiums are unfair or deceptive is really ridiculous.

Already there are existing regulations that limit the total amount of revenue that could be generated on a single transaction. This effectively limits how much yield spread premium can be generated. These regulations are currently protecting consumers from abusive practices.

**Conclusion: Labeling yield spread premiums as unfair or deceptive practices is "unfair". HUD requires yield spread premiums to be disclosed upfront with their new GFE. Since it will be disclosed, it's not deceptive. If brokers offer a better rate than a bank; why are yield spread premiums unfair?**

### **Small Business Devastation: The Elimination of Mortgage Brokers**

The existence of mortgage brokers depends on our ability to earn yield spread premiums. R-1366 will drive all mortgage brokers out of business. It is that simple. Mortgage brokers would not be able to compete with larger lenders who would still generate service release premiums. The only way for brokers to survive would be to charge consumers up-front. However, this creates an unfair advantage to lenders across the country because their loans will appear less expensive. The Board has to realize that non-competitive markets and unfair business advantages are never good consumers.

Worse yet, small brokerages won't have the opportunity to grow into larger lenders. The American Dream for brokers and originators would be abolished. Only organizations with large amounts of capital would be able to enter the mortgage lending industry. This would only increase the affect that large banks could have on our economy. I can't believe The Board is considering a proposal that would cause this much damage.

Mortgage brokers across the country employ people, provide benefits, purchase goods and services, pay taxes, pay state fees, and provide a much needed service to consumers. Mortgage brokers also provide a service to the lenders they originate for. Mortgage brokers provide lenders with a local presence and a sales force in areas that would otherwise not have one. Mortgage brokers also work closely with consumers, meet their needs, and often help consummate some of the toughest transactions. Mortgage brokers are important.

Also, the overwhelming majority of mortgage brokers are small businesses. The Board would be shutting down thousands of small businesses across the country. How does that make any sense a time when President Obama is proposing things to help small businesses? Destroying the mortgage broker would only increase unemployment and put other ancillary businesses out as well.

Putting small business out is never the right choice. I believe there are things we can do to improve our industry that won't eliminate mortgage brokers. The Board has a responsibility to help promote small business and increase homeownership. I think I have clearly demonstrated that R-1366 would not be inline with that responsibility.

**Conclusion: Eliminating yield spread premiums would create an unfair advantage to large lenders and banks. It would also devastate small mortgage businesses across the country. This would not be good for consumers. Unemployment would rise, our economy would get worse, and the housing market may never fully recuperate.**

### **Alternatives: A Better Solution**

I have demonstrated that R-1366 would have devastating effects on the economy, consumers, and the mortgage industry alike. However, that does not mean things should stay the same. I believe that reforms are necessary. We must do things to ensure that the dream of homeownership is never again jeopardized. However, I think that we can make those reforms and improve our industry without the negative consequences of R-1366.

As I stated before, the most destructive problem with the mortgage industry was "steering". We should never allow loan originators to advise consumers into loans that would be harmful, simply because they would earn more income on those loans. Maybe if "steering" had been controlled; then negative amortization loans would not have destroyed so many families. Maybe borrowers would not have been talked into ARM or interest only loans without understanding their consequences.

The Board should focus on ways to prevent "steering". Borrowers should be educated about the decisions they are making, without influence. Therefore, I proposed that the simplest solution would be Transaction Based Consumer Counseling.

Let's consider how reverse mortgages work. Basically they are negative amortization loans, insured by the government. But it is because of this government backing that FHA came up with a genius requirement. Senior Americans must receive consumer counseling before they are able to accept a reverse mortgage. In an effort to protect Senior Americans from abusive practices, FHA requires this counseling. This removes all influence from loan originators in the decision making process. Seniors receive unaffiliated education and counseling about the loan they are considering. I think we should adopt the same concept in all mortgage lending.

Before any borrower is able to consummate a "non-traditional" type of mortgage transaction; they must complete a consumer counseling program. This requirement should exist for ARMs, negative amortization loans, balloon mortgages, prepayment penalties, interest only loans, stated income loans, etc. Any loan that is not a traditional fixed rate and fixed payment, must be subject to this requirement.

Can you imagine the impact? Think about how different the housing market would be if borrowers had been counseled before closing on negative amortization loans. I think we can assume that fewer homeowners would have accepted these loans. As a result, fewer would have found themselves in foreclosure. This counseling would eliminate the problem of "steering".

Transaction Based Consumer Counseling is the answer. Any borrower who is contemplating one of these "non-traditional" or "exotic" mortgage transactions must undergo counseling. It's only fair to the American people that we do this. The answer is obviously education for the consumer. If the consumers were better informed about the consequences of these loans; many would opt out of them. Consumers could also be consulted into comparing mortgage offers and shopping around.

This consumer counseling doesn't have to be long and arduous either. A simple 45 minutes or even 60 minutes of counseling would suffice. The counseling can be tailored to be specific to the type of loan the consumer is considering. For example; ARM loans would have a different type of counseling than negative amortization loans would. Consumers would receive up to an hour of counseling, independent of the originator, and could then make an informed decision.

Here's the best part; this alternative would not cause small businesses to fail. To the contrary it would create opportunity for more small businesses. Companies would open across the country to offer this type of counseling. These companies would have to be licensed, train employees, pay taxes, etc. People would be put to work!

Also, this alternative doesn't have to cost consumers a dime. The Board could mandate that lenders or brokers must bear the cost of this counseling on consummated loans. Consumers would have to pay for their counseling upfront; but lenders and brokers must reimburse consumers once their transactions closed. The possibilities are endless with this alternative.

Another alternative would be for The Board to issue public advisory messages. The Board could prepare several short videos that educate consumers. These videos topics could range from comparing mortgage offers, to "exotic" loan types, to even yield spread premiums. The Board could post these videos onto their website. Traffic to these videos could be driven by small television advertisements. Just a few TV ads and millions of Americans would be flocking to The Board's website to view these videos.

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**Conclusion: We have options and alternatives. Transaction Based Consumer Counseling is a better alternative to putting small business out of work. Counseling consumers before they can accept a “non-traditional” mortgage loan makes sense anyway you look at it. This alternative would create jobs instead of eliminate them. TV ads could drive other Americans to view educational videos issued by The Board. These short videos could educate consumers and make a huge impact.**

In closing, I would like to thank The Board for taking the time to read and consider my letter. I hope that I have helped The Board see that R-1366 will have some devastating affects on consumers and small business. The Board must not stifle flexibility in the mortgage lending industry at a time when we need it the most. There are alternatives that will be an improvement to the industry and to homeowners. We should consider putting those alternatives to work before enacting such harsh regulations. The Board should consider that never before has a governing body imposed restrictions on how private businesses must compensate their employees. R-1366 would be the first of it's kind. Is that type of intrusions really what our economy needs?

Now, I do believe The Board is genuinely trying to protect consumers and prevent this disaster from ever happening again. You're tasked with the difficulty of finding harmony between consumers and our industry. For that, your efforts are commendable.

I am available to discuss any of the topics in this letter. I also offer myself to The Board for any testing or polling. In addition, my brokerage is open to The Board if you'd ever like to send someone to see how we conduct our business and how YSP impacts that. Please feel free to reach out to me at any time.

Sincerely yours,

Roger Sanchez